[JOINT COMMITTEE PRINT]

BACKGROUND
RELATING TO
THE EFFECT OF RACIALLY DISCRIMINATORY POLICIES ON THE TAX-EXEMPT STATUS OF PRIVATE SCHOOLS

PREPARED FOR THE

COMMITTEE ON WAYS AND MEANS

AND THE

COMMITTEE ON FINANCE

BY THE STAFF

OF THE

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Errata Sheet for Joint Committee print entitled Background Relating to the Effect of Racially Discriminatory Policies on the Tax-Exempt Status of Private Schools (JCS-1-82, January 29, 1982)

On page 10, the first sentence of the second full paragraph should refer to section 7605(c) instead of section 7605(a).

On page 20, substitute the following for the second full paragraph:

Also in connection with the court-ordered IRS survey, the Clarksdale Baptist Church has been allowed to intervene in the District Court proceedings, where it contends that IRS requests for information from church-affiliated schools as part of such survey are in violation of the First Amendment to the Constitution. On July 13, 1981, the District Court suspended its modified injunction to the extent the injunction applied to church-operated schools in Mississippi, pending resolution of the issues raised by the Clarksdale Baptist Church. On January 6, 1982, the District Court stayed all further proceedings, pending the Supreme Court's ruling in the Bob Jones University and Goldsboro Christian Schools, Inc., cases (discussed below).

On page 21, the second sentence of the fourth full paragraph should read as follows: This initial proposal was substantially revised and on February 9, 1979, the IRS published another proposed revenue procedure. 10/

On page 22, at the end of the first full paragraph, add the following sentence: In addition, the Subcommittee on Taxation and Debt Management of the Senate Finance Committee held a hearing on these proposed procedures on April 27, 1979.

On page 28 substitute for the second full paragraph the following:

In July, 1981, both Bob Jones University and Goldsboro Christian Schools, Inc. filed petitions for writs of certiorari seeking U.S. Supreme Court review of the Fourth Circuit decisions upholding the legality of the denial of their tax-exempt status.

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INTRODUCTION

The Senate Committee on Finance and the House Committee on Ways and Means have scheduled public hearings on the Federal Government's policy regarding the effect of racial discrimination on the tax-exempt status of private schools. The Finance Committee hearing is scheduled for February 1, 1982, and the Ways and Means Committee hearing is scheduled to begin on February 4, 1982. This pamphlet has been prepared by the staff of the Joint Committee on Taxation in connection with these hearings.

The first part of the pamphlet is an overview of the matters described in more detail in later parts. The second part describes recent developments relating to the Administration's position on the effect of racially discriminatory policies on tax-exempt status for private schools. The third part briefly describes Internal Revenue Code provisions relating to tax-exempt status for schools and deductibility of contributions to schools. The fourth part describes, in chronological order, developments regarding the effect of racially discriminatory policies on tax-exempt status for private schools, including court decisions and Internal Revenue Service rulings and procedures. The fifth part describes court decisions as to the tax-exempt status of Bob Jones University and Goldsboro Christian Schools, Inc. Finally, the sixth part of the pamphlet describes the Administration's legislative proposal relating to denial of tax-exempt status to private schools which have policies of racial discrimination.

I. OVERVIEW

This overview summarizes various judicial, administrative, and legislative actions involving the tax-exempt status of certain organizations and the question of racial discrimination.

The Internal Revenue Code provides tax-exempt status under section 501(c)(3) for organizations which are "organized and operated exclusively for religious, charitable, scientific, or educational purposes * * *." Generally, organizations exempt under section 501(c)(3) are entitled to receive contributions which are deductible by the donor under section 170.

In 1954, the U.S. Supreme Court, in *Brown* v. *Board of Education*,[1] held that racial discrimination in public education was unconstitutional. Prior to 1970, the IRS policy on tax exemptions for private schools was that tax-exempt status was available to racially discriminatory private schools so long as those schools were not receiving aid from a State or political subdivision of a State so as to make operation of the school unconstitutional or in violation of Federal law.

On July 10, 1970, during the litigation of *Green* v. *Connally*,[2] the IRS announced that private schools which practice racial discrimination would not be recognized as tax exempt under section 501(c)(3) or as eligible for tax-deductible contributions under section 170.[3] The U.S. District Court for the District of Columbia held, in *Green*, that racially discriminatory private schools are not entitled to the Federal tax exemption provided for educational organizations and that gifts to such schools are not deductible as charitable contributions by the donors.

The District Court, in *Green*, placed the IRS under a permanent injunction to deny tax exemptions to private schools in Mississippi that practice racial discrimination as to students. The Court also ordered the IRS to implement its decision by requiring such schools to adopt and publish a nondiscriminatory policy and provide the IRS with information to enable the IRS to determine if the schools discriminate on the basis of race. The U.S. Supreme Court affirmed, per curiam (without opinion), the District Court's decision in Green.[4]

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[1] 347 U.S. 483 (1954).

[2] 330 F. Supp. 1150 (D.D.C.) aff'd per curiam sub nom. *Coit* v. *Green*, 404 U.S. 997 (1971) (hereinafter *Green*).

[3] See IRS News Release, July 10, 1970. At the time of the IRS News Release, the IRS was under a U.S. District Court preliminary injunction not to approve any application for tax-exempt status by any private school in Mississippi or determine that any contribution to such school was deductible unless the IRS affirmatively determined that the school was not part of a system of racially segregated private schools operated as an alternative for white students seeking to avoid desegregated public schools. See *Green* v. *Kennedy*, 309 F. Supp. 1127, 1150 (D.D.C. 1970), appeal dismissed sub nom. *Cannon* v. *Green*, 398 U.S. 956 (1970).

[4] *Coit* v. *Green*, 404 U.S. 997 (1971).

After the *Green* case, the IRS issued a revenue ruling and a revenue procedure,[5] in 1971 and 1972, which stated that private schools with racially discriminatory policies as to students would not be recognized as organizations exempt from Federal income tax. These documents also set forth guidelines for determining whether certain private schools have adequately publicized their racially nondiscriminatory policies so as to enable them to qualify for tax-exempt status.

In 1975, the IRS published Revenue Procedure 75–50,[6] which set forth guidelines and recordkeeping requirements for determining whether private schools have racially nondiscriminatory policies. A school's failure to comply with these guidelines ordinarily would result in the proposed revocation of the tax-exempt status of the school. In Revenue Ruling 75–231,[7] the IRS stated that private schools operated by churches, like other private schools, could not retain their tax-exempt status if they were racially discriminatory as to students.

In 1976, the plaintiffs in the *Green* case sought further injunctive relief from the U.S. District Court, asserting that the IRS was not complying with the Court's continuing injunction that Mississippi private schools that are racially discriminatory be denied tax-exempt status. The Court then modified and supplemented the permanent injunction relating to the tax-exempt status of Mississippi private schools that racially discriminate.[8] In a companion suit to *Green*,[9] parents of black children attending public schools in several States sought declaratory and injunctive relief to require the IRS to deny applications for tax-exempt status, on a nationwide basis, to schools that racially discriminate. The District Court dismissed this suit on the ground that the parents lacked "standing" to bring the suit. The U.S. Court of Appeals for the D.C. Circuit, in a 2–1 decision, reversed the District Court and held that the suit could be maintained. The Government has filed a petition for a writ of certiorari seeking U.S. Supreme Court review of the standing issue in this case.

In response to the reopening of the *Green* case and the *Wright* litigation, the IRS, on August 22, 1978, published a proposed revenue procedure intended to provide more effective guidelines for identifying private schools that racially discriminate as to students.[10] After substantial revision, the IRS published another proposed revenue procedure in 1979.[11]

Through provisions enacted as part of appropriations legislation, Congress has forbidden the IRS to develop or carry out any rulings, procedures, or other positions concerning tax exemption for racially discriminatory private schools beyond those that were in effect prior to August 22, 1978 (the publication date for the initial version of the revenue procedure). Accordingly, neither the 1978 proposed revenue

[5] See Rev. Rul. 71–447, 1971–2 C.B. 230 and Rev. Proc. 72–54, 1972–2 C.B. 834.
[6] 1975–2 C.B. 587.
[7] 1975–1 C.B. 158.
[8] See *Green* v. *Miller*, 45 AFTR 2d 80–1566 (D.D.C. 1980).
[9] *Wright* v. *Miller*, 490 F. Supp. 790 (D.D.C. 1979), rev'd sub nom. *Wright* v. *Regan*, 656 F. 2d 820 (D.C. Cir. 1981).
[10] I.R. News Release 2027. This proposed revenue procedure was published in the Federal Register on August 22, 1978.
[11] I.R. News Release 2091. This revised proposed revenue procedure was published in the Federal Register on February 13, 1980.

procedure nor the 1979 revised proposed revenue procedure has been implemented.

In *Prince Edward School Foundation* v. *United States*,[12] the U.S. District Court for the District of Columbia, following its decision in *Green*, held that a nonprofit private school in Virginia was not entitled to tax exemption under section 501(c)(3) because of its racially discriminatory admissions policy.

In *Bob Jones University* v. *United States*,[13] the U.S. Court of Appeals for the Fourth Circuit, (in a 2–1 decision), reversing the U.S. District Court decision in the case, held that the IRS revocation of the University's tax-exempt status because of its racially discriminatory policies violates neither the statutory mandate of section 501(c)(3) nor the First Amendment to the Constitution. In *Goldsboro Christian Schools, Inc.* v. *United States*,[14] the Fourth Circuit affirmed, in an unpublished opinion, the District Court's holding that private schools maintaining racially discriminatory admissions policies violate clearly declared public policies of the United States and, therefore, must be denied tax-exempt status under section 501(c)(3). The Fourth Circuit affirmed (in a 2–1 decision) on the basis of its opinion in *Bob Jones University*. On October 13, 1981, the U.S. Supreme Court agreed to review both of these cases.

On January 8, 1982, the Justice Department, in connection with the Treasury Department's announcement on the same day, requested the Supreme Court to vacate, as moot, the judgments of the Fourth Circuit in the Bob Jones University and Goldsboro Christian Schools, Inc. cases. The Government's Memorandum stated that the Treasury Department has initiated the steps necessary to provide Bob Jones University and Goldsboro Christian Schools, Inc. with tax-exempt status and to refund to them the Federal social security and unemployment taxes in dispute. The Memorandum also stated that the Treasury Department has commenced the process necessary to revoke certain IRS rulings related to denial of tax-exempt status to private schools that racially discriminate.

The Administration has submitted to Congress legislation to prohibit tax-exempt status for private, nonprofit educational organizations that have racially discriminatory policies.

[12] 478 F. Supp. 107 (D.D.C. 1979) aff'd by unpublished order No. 79–1622 (D.C. Cir. June 30, 1980), cert. denied. 450 U.S. 944 (1981).

[13] 468 F. Supp. 890 (D.S.C. 1978), rev'd 639 F. 2d 147 (4th Cir. 1980), cert. granted —— U.S. —— (October 13, 1981).

[14] 436 F. Supp. 1314 (E.D.N.C. 1977), aff'd in an unpublished opinion (4th Cir. February 24, 1981), cert. granted —— U.S. —— (October 13 ,1981).

II. RECENT DEVELOPMENTS RELATING TO THE ADMINISTRATION'S POSITION ON THE TAX-EXEMPT STATUS OF CERTAIN PRIVATE SCHOOLS

Treasury announcement

On January 8, 1982, the Treasury Department announced that "without further guidance from Congress, the Internal Revenue Service will no longer revoke or deny tax-exempt status for religious, charitable, educational, or scientific organizations on the grounds that they don't conform with certain fundamental public policies." In particular, the announcement pointed out that under prior Treasury policy, the Internal Revenue Service had revoked the tax exemption of organizations which "did not adhere to certain fundamental national policies, such as those forbidding discrimination on the basis of race * * *." The announcement stated that the Treasury's change in position "reflects the advice of the Department of Justice that the authority which the IRS previously had been asserting as its basis for revoking the tax exemptions" of certain private schools "is not supported by the language of the Internal Revenue Code or its legislative history."

Government position in Supreme Court cases

Also on January 8, 1982, the Justice Department requested the U.S. Supreme Court to vacate, as moot in light of the new Treasury policy announced that day, two decisions of the U.S. Court of Appeals for the Fourth Circuit which had upheld IRS actions regarding tax-exempt status for Bob Jones University and for Goldsboro Christian Schools, Inc. The Supreme Court had agreed on October 13, 1981, to review these two cases.

The IRS had revoked its determination letter which previously recognized tax-exempt status (and eligibility to receive tax-deductible contributions) for Bob Jones University, on the ground that certain racial policies of the University precluded favorable tax treatment under section 501(c)(3) of the Internal Revenue Code. The University had challenged that IRS position through litigation in the U.S. District Court for South Carolina, which held that the University did qualify for tax exemption. On appeal, this decision was reversed by the Fourth Circuit, which sustained IRS authority to revoke the University's tax-exempt status in light of its racial policies.

Likewise, the IRS had determined that Goldsboro Christian Schools, Inc. did not qualify for tax-exempt status (or eligibility to receive tax-deductible contributions) on the ground that the organization maintained a racially discriminatory admissions policy. In litigation brought by that organization to challenge the IRS action, the U.S. District Court for the Eastern District of North Carolina upheld the denial of favorable tax treatment, and the Fourth Circuit affirmed that decision on appeal.

The Justice Department's Memorandum to the Supreme Court (asking that the judgments of the Fourth Circuit be vacated as moot) stated that "the Department of the Treasury has initiated the necessary steps to grant petitioner Goldsboro Christian Schools tax-exempt status under section 501(c)(3) of the Code, and to refund to it federal social security and unemployment taxes in dispute." The Memorandum also stated that "the Treasury Department has initiated the necessary steps to reinstate tax-exempt status under section 501(c)(3) of the Code to petitioner Bob Jones University, and will refund to it federal social security and unemployment taxes in dispute." The Memorandum further stated that "the Treasury Department has commenced the process necessary to revoke forthwith the pertinent Revenue Rulings that were relied upon to deny petitioners tax-exempt status under the Code." [1]

Administration's proposed legislation

On January 12, 1982, the White House issued a statement concerning the tax-exempt status of nonprofit, private, educational institutions. In that statement, President Reagan said that "I am unalterably opposed to racial discrimination in any form" and that "I am also opposed to administrative agencies exercising powers that the Constitution assigns to the Congress." The President further stated that "I believe the right thing to do on this issue is to enact legislation which will prohibit tax exemptions for organizations that discriminate on the basis of race. Therefore, I will submit legislation and will work with the Congress to accomplish this purpose."

On January 18, 1982, President Reagan transmitted to Congress proposed legislation to deny tax-exempt status to schools that are racially discriminatory. The proposal, which would be retroactive to July 10, 1970, would prohibit the granting of tax-exempt status to private schools with racially discriminatory policies. This proposal is described in Part VI, below.

In his transmittal letter, the President stated that "I pledge my fullest cooperation in working" with Congress "to enact such legislation as rapidly as possible." The President further stated that he had been advised that the Treasury Department would not act on any applications for tax exemptions filed in response to the Treasury policy announced on January 8, 1982, until Congress has acted on the proposed legislation.

Also, on January 18, 1982, the Treasury Department announced that the Secretary of the Treasury has instructed the Commissioner of Internal Revenue not to act on any applications for tax-exempt status filed in response to the new Treasury policy announced on January 8, 1982, except in the cases of Bob Jones University and Goldsboro Christian Schools, Inc., until Congress has acted on the proposed legislation.

[1] The Memorandum identified these IRS rulings as Rev. Rul. 71–447, 1971–2 C.B. 230; Rev. Proc. 72–54, 1972–2 C.B. 834; Rev. Rul. 75–231, 1975–1 C.B. 158; and Rev. Proc. 75–50, 1975–2 C.B. 587. These rulings are described in Parts IV–D and IV–E, below.

III. INTERNAL REVENUE CODE PROVISIONS

Tax exemption under section 501(c)(3)

Section 501(a) of the Internal Revenue Code of 1954 provides for the exemption from Federal income tax of certain organizations described in section 501(c)(3). These are organizations that are "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual," and which meet certain other specified requirements.[1]

Service performed by employees of an organization described in section 501(c)(3) is not subject to the unemployment insurance tax (sec. 3306(c)(8)) or the social security tax (sec. 3121(b)(8)(B)). However, pursuant to section 3121(k)(1), a section 501(c)(3) organization may elect FICA coverage for its employees.

Tax deductions under section 170

Section 170 of the Code generally allows income tax deductions for charitable contributions, as defined in section 170(c). Under section 170(c), the term "charitable contribution" generally includes a con-

[1] Code sec. 501(c)(3) has its origin in sec. 32 of the Tariff Act of 1894, which provided for the exemption from income tax of "corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes" (Tariff Act of 1894, ch. 349, sec. 32, 28 Stat. 556). A similar exemption provision was included in every subsequent revenue act prior to the 1954 Code (1939 Code, sec. 101(6)); Revenue Act of 1938, ch. 289, § 101(6), 52 Stat. 481; Revenue Act of 1936, ch. 690, § 101(6), 49 Stat. 1674; Revenue Act of 1934, ch. 277, § 103(6), 48 Stat. 700; Revenue Act of 1932, ch. 209, § 103(6), 47 Stat. 193; Revenue Act of 1928, ch. 852, § 103(6), 45 Stat. 813; Revenue Act of 1926, ch. 27, § 231(6), 44 Stat. 40; Revenue Act of 1924, ch. 234, § 231(6), 43 Stat. 282; Revenue Act of 1921, ch. 136, § 231(6), 42 Stat. 253; Revenue Act of 1918, ch. 18, § 231(6), 40 Stat. 1076; Revenue Act of 1916, ch. 463, § 11(a)(6), 39 Stat. 766; Tariff of 1913, ch. 16, § 11(G)(a), 38 Stat. 172; Tariff of 1909, ch. 6, § 38, 36 Stat. 113).

The statutory provision for exemption of certain organizations (now Code sec. 501(c)(3)) has been amended eight times since 1913. The statutory provision was amended in 1913 to provide a reference to "scientific" purposes (Tariff of 1913, ch. 16, § II(G)(a), 38 Stat. 172); in 1918, to add a reference to purposes of "prevention of cruelty to children or animals" (Revenue Act of 1918, ch. 18, § 231(6), 40 Stat. 1076); in 1921, to add a reference to "literary" purposes (Revenue Act of 1921, ch. 136, § 231(6), 42 Stat. 253); in the 1954 Code, to add a reference to purposes of "testing for public safety" (1954 Code, sec. 501(c)(3)); and in 1976, to add a reference to certain "amateur sports competition" purposes (Tax Reform Act of 1976, sec. 1313, 90 Stat. 1730). A prohibition against certain activities to influence legislation was added in 1934 (Revenue Act of 1934, ch. 277, § 101(6), 48 Stat. 700), and amended in 1976 (Tax Reform Act of 1976, sec. 1307(d)(1)(A), 90 Stat. 1727), and a prohibition against certain political campaign activities was added in the 1954 Code (1954 Code, sec. 501(c)(3)).

tribution or gift to, or for the use of, an organization that is organized and operated exclusively for the same purposes as enumerated in section 501(c)(3).[2] Thus, a private school that is exempt from tax under section 501(c)(3) generally is entitled to receive contributions that are deductible by the donors. Bequests and gifts to organizations described in section 501(c)(3) also are deductible under the estate and gift tax provisions (secs. 2055, 2522).

Recognition of tax-exempt status

Prior to enactment of the Tax Reform Act of 1969, an organization which met the requirements of section 501(c)(3) was tax exempt whether or not it applied to the IRS for a determination letter recognizing its exempt status. However, pursuant to the 1969 Act, an organization organized after October 9, 1969, generally is not treated as exempt under section 501(c)(3) unless it applies for recognition of its exempt status. This requirement does not apply to churches (and their integrated auxiliaries), to conventions or associations of churches, to organizations (other than private foundations) whose annual gross receipts normally are not more than $5,000, and to certain other organizations which the Treasury may exempt by regulation (sec. 508).

An organization seeking recognition of exempt status under section 501 is required to file an application with the District Director of Internal Revenue for the district where the principal place of business or principal office of the organization is located. A ruling or determination letter will be issued to an organization by the Internal Revenue Service if the organization's application and supporting documents establish that it meets the particular requirements of the section under which exemption is claimed. Exempt status will be recognized in advance of an organization's operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will meet the particular requirements of the section under which exemption is claimed. In order to qualify for exemption, the organization is required to describe fully the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities; the anticipated source of receipts; and the nature of contemplated expenditures. Under certain circumstances, the IRS may require submission of a record of actual operations before an exemption determination may be issued.

Code section 7428, added by the Tax Reform Act of 1976, provides that the U.S. Tax Court, the U.S. Court of Claims, or the U.S. District Court for the District of Columbia has jurisdiction in the case of any actual controversy involving an IRS determination (or failure to make a determination) as to the initial qualification, or continuing qualification, of an organization as tax exempt under section 501(c)(3), and as a qualified charitable donee under section 170(c). Under certain circumstances, contributions (not to exceed $1,000 per individual per organization) made after an adverse determination by the IRS and during the period of litigation over tax-exempt status may be deduct-

[2] However, a contribution to a tax-exempt organization that is organized and operated for the purpose of testing for public safety is not included in the section 170(c) definition of charitable contributions.

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ible even though the court ultimately determines that the organization had lost its status as an eligible charitable donee under section 170(c). Section 7428 applies with respect to IRS determinations (or requests for IRS determinations) made after January 1, 1976.

Information from tax-exempt organizations

Present law (sec. 6033) provides generally that every organization exempt from tax under section 501(a) must file an annual information return, showing its gross income, receipts, disbursements, and such other information as prescribed by Treasury regulations. However, this filing requirement does not apply to churches (and their integrated auxiliaries), to conventions or associations of churches, to organizations (other than private foundations) whose annual gross receipts normally are not more than $5,000, to the exclusively religious activities of any religious order, and to other organizations which the Treasury may exempt by regulations.

Section 7605(a) imposes certain restrictions on IRS examination of a church (or convention or association of churches). That provision generally precludes the IRS from examining religious activities of such an organization for any purpose other than to determine whether the organization qualifies for tax exemption as a church (or convention or association of churches).

Restriction on exemptions for social clubs

In 1976, Congress added a provision to section 501 that generally denies tax exemption to an organization described in section 501(c)(7) [3] if its charter, bylaws, or other governing instrument (or other written policy statement) contains a provision that provides for discrimination against any person on the basis of race, color, or religion (sec. 501(i)). The purpose of enacting section 501(i) was to overrule the portion of the decision in *McGlotten* v. *Connally*, 338 F. Supp. 448 (D.D.C. 1972), which held that social clubs could be exempt from tax notwithstanding racially discriminatory membership policies.[4]

[3] These organizations are clubs organized for pleasure, recreation, and other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of private shareholders. Services performed for these organizations are not exempt from FICA tax or FUTA tax, and contributions to these organizations are not deductible as charitable contributions. Furthermore, these organizations are taxed on income other than from members (sec. 512(a)(3)).

[4] In the *McGlotten* case, the three-judge U.S. District Court for the District of Columbia distinguished social clubs (exempt under section 501(c)(7)) from fraternal organizations (exempt under section 501(c)(8)). The Court stated that the section 501(c)(7) exemption, which is limited to membership-generated funds, does not operate as a grant of Federal funds. The Court noted that "Congress has determined that in a situation where individuals have banded together to provide recreational facilities on a mutual basis, it would be conceptually erroneous to impose a tax on the organization as a separate entity." The Court further found that there was no other act of Government involvement in racial discrimination by section 501(c)(7) organizations. Accordingly, the Court concluded that the section 501(c)(7) exemption did not violate the U.S. Constitution or come within the prohibition of the 1964 Civil Rights Act against Federal financial assistance to racially discriminatory programs or activities.

However, the Court further concluded that the exemption for fraternal organizations under section 501(c)(8) stood on a different footing than the section 501(c)(7) exemption. The Court considered the most crucial difference to be the

The Senate Finance Committee Report on the legislation adding this provision (P.L. 94–568) states that: "In view of national policy, it is believed that it is inappropriate for a social club or a similar organization described in section 501(c)(7) to be exempt from income taxation if its written policy is to discriminate on account of race, color, or religion." [5]

fact that fraternal organizations are not taxed on their passive investment income. The Court thus concluded that the section 501(c)(8) exemption amounted to sufficient Government involvement to invoke the Fifth Amendment to the Constitution and to fall within the prohibition of the Civil Rights Act of 1964. The Court also stated that the provision of a tax deduction for contributions to a section 501(c)(8) organization for certain charitable, etc. purposes is a grant of Federal financial assistance within the scope of the 1964 Civil Rights Act. Accordingly, the Court ruled that racially discriminatory section 501(c)(8) organizations cannot be tax exempt or eligible to receive tax-deductible contributions.

[5] S.Rep. No. 94–1318, 94th Cong., 2d Sess. (1976). The Finance Committee Report noted that the *Green* case, *supra*, had held that discrimination on account of race is inconsistent with an educational institution's tax-exempt status under sec. 501(c)(3) and with its status as a charitable contribution donee under sec. 170 (n. 5).

III. HISTORY OF POLICY REGARDING EFFECT OF RACIAL DISCRIMINATION ON TAX-EXEMPT STATUS OF PRIVATE SCHOOLS

A. *Brown* v. *Board of Education*

In 1954, the U.S. Supreme Court held that racial discrimination in public education violates the U.S. Constitution (*Brown* v. *Board of Education*, 347 U.S. 483 (1954)). In that case, the Supreme Court held that the segregation of white and black children in the public schools solely on the basis of race, pursuant to State laws permitting or requiring such segregation, is a denial to black children of the equal protection of the laws guaranteed by the Fourteenth Amendment. The Court held that such segregation would be unconstitutional even if the physical facilities and other tangible factors of separate white and black schools were equal.

B. IRS Policies Prior to 1970

In 1965, the IRS suspended issuance of exemption rulings to private schools in order to consider the effect of racial discrimination on tax-exempt status. This suspension was effectuated administratively through a supplement to the Internal Revenue Manual that was issued on November 5, 1965.

In 1967, the IRS announced that it had resumed ruling on the tax-exempt status of private schools.[1] This resumption of ruling followed "an extensive review of judicial and legislative developments in the civil rights area" to determine the effect of those developments on the qualification of private schools for tax exemption. In resuming ruling, the IRS stated that tax exemption would be denied to a private school (and contributions to the school would not be tax-deductible) if the school was operated on a segregated basis and if its involvement with the State or political subdivision was such as to make its operation unconstitutional or a violation of Federal law. However, if a private school did not have such a degree of involvement with the political subdivision as had been determined by the courts to constitute State action for constitutional purposes, then tax exemption would be available.

Also, in 1967, the IRS issued a revenue ruling (Rev. Rul. 67–325, 1967–2 C.B. 113) dealing with an organization that provided recreational facilities which were restricted to less than the entire community on the basis of race. That ruling provided that the organization was not exempt from tax and that contributions to it were not deductible. The ruling stated that "sections 170, 2055, 2106, and 2522 of the Code, to the extent that they provide deductions for contribu-

[1] IRS News Release, August 2, 1967.

tions or other transfers to or for the use of organizations organized and operated exclusively for charitable purposes, or to be used for exclusively charitable purposes, do not apply to contributions or transfers to any organization whose purposes are not charitable in the generally accepted legal sense * * *."

Under the IRS ruling policy that was in effect until July 10, 1970, tax exemption was available to a racially discriminatory private school unless there was governmental involvement with the school that constituted State action. That policy was challenged in *Green* v. *Connally*, the litigation described below.

C. *Green* v. *Connally*

Positions taken by parties in case

The *Green* case was a class action suit brought in the U.S. District Court for the District of Columbia by parents of black children attending public schools in Mississippi to enjoin Treasury Department officials from according tax-exempt status and deductibility of contributions to private schools in Mississippi that discriminated against black students. The plaintiffs argued that granting tax benefits to such schools violated the provisions of the Internal Revenue Code. In the alternative, the plaintiffs argued that if the granting of tax-exempt status to those schools were authorized by the Code, then to that extent sections 170 and 501 were unconstitutional.[2]

On July 10, 1970, during the litigation of the case in the District Court, the IRS announced that it could no longer legally justify recognizing tax-exempt status for private schools that practice racial discrimination, nor could it treat gifts to such schools as charitable deductions for income tax purposes.[3] Initially, the Government had taken the position that the plaintiffs lacked standing to sue, and that the grant of tax exemptions to private schools did not amount to unconstitutional government action.

Dan Coit and other individuals intervened in the case as representatives of the class of parents and children who supported or attended private, nonprofit schools in Mississippi that enrolled only members of the white race and that were established as an alternative for white students who did not wish to attend desegregated public schools. The intervenors' principal contention was that denial of tax exemption would violate their First Amendment right to associate in private schools of their choice.

Decision of U.S. District Court

The three-judge District Court, in *Green*, held that racially discriminatory private schools are not entitled to the Federal tax exemption provided for educational institutions and that persons making gifts

[2] During this litigation, the District Court, on January 13, 1970, issued a preliminary injunction against the IRS to restrain it from approving applications for tax-exempt status by Mississippi private schools. Furthermore, on June 26, 1970, the Court entered a supplemental order requiring the IRS to suspend advance assurances of deductibility of contributions to segregated private schools in Mississippi. See *Green* v. *Kennedy*, 309 F. Supp. 1127 (D.D.C. 1970), appeal dismissed sub nom. *Cannon* v. *Green*, 398 U.S. 956 (1970), and *Green* v. *Kennedy*, 309 F. Supp. 1150 (D.D.C. 1970).

[3] See IRS News Release, July 10, 1970.

to such schools are not entitled to the deductions provided in the case of gifts to educational institutions 330 F. Supp. 1150 (D.D.C. 1971)).

In its opinion, the Court stated that there "is at least grave doubt whether an educational organization that practices racial discrimination can qualify as a charitable trust under general trust law." The Court pointed out that while "in the past the traditional law of charities embraced educational trusts for the benefit of a racially defined class, there is grave doubt whether this rule has continuing vitality in view of recent values which govern the application of charitable trust law." The Court further pointed out that the "cases indicate a trend that racially discriminatory institutions may not validly be established or maintained even under the common law pertaining to educational charities." However, the Court concluded that the ultimate criterion for determining whether private schools are eligible under the charitable organization provisions of the Code rests on Federal policy rather than on the common law.

The Court stated that it is a general and well established principle that the Congressional intent in providing tax deductions and exemptions is not construed to be applicable to activities that are either illegal or contrary to public policy. It noted that there are a number of cases where business expense or other deductions are denied on the grounds that the allowance of the deductions would frustrate public policy. The Court cited the Civil Rights Act of 1964 as an expression of the Federal public policy against government support for racial segregation of public or private schools, and found that the Internal Revenue Code provisions on charitable exemptions and deductions must be construed to avoid frustrations of public policy.

Because the Court concluded that the Internal Revenue Code, as limited by the public policy doctrine, does not provide tax exemptions for racially discriminatory private schools nor deductions for contributions to such schools, it was able to avoid the issue raised by the plantiffs of whether the allowance of exemptions and deductions would be unconstitutional. The Court stated, however, that a contrary construction of the Code would raise serious constitutional questions.[4]

Responding to the arguments advanced by the intervenors, the Court also held that the First Amendment right of association does not extend to government support for policies and practices of racial discrimination among students, and that the governmental and constitutional interest of avoiding racial discrimination in educational institutions embraces the interest of avoiding even the indirect economic benefit of tax exemption. While noting that it was not called upon to determine whether tax exemption would be available to a religious school that discriminated racially, the Court pointed out that the law may prohibit an individual from taking certain actions even though his religion commands or prescribes them.

[4] "Clearly the Federal Government could not under the Constitution give direct financial aid to schools practicing racial discrimination. But tax exemptions and deductions certainly constitute a Federal Government benefit and support. While that support is indirect, and is in the nature of a matching grant rather than an unconditional grant, it would be difficult indeed to establish that such support can be provided consistently with the Constitution. The propriety of the interpretation approved by this Court is underscored by the fact that it obviates the need to determine such serious constitutional claims." (330 F. Supp. at 1164–65)

Relief granted by District Court

The Court placed the IRS under a permanent injunction to deny tax exemption to private schools in Mississippi that practice racial discrimination with respect to students, and ordered the IRS to implement its decision by requiring schools seeking tax-exempt status to adopt and publish a nondiscriminatory policy and to provide certain statistical and other information to enable the IRS to determine if the schools are racially discriminatory. While the injunction granted in *Green* applied only to Mississippi private schools, the Court stated that "the underlying principle is broader, and is applicable to schools outside Mississippi with the same or similar badge of doubt." (This "badge of doubt" resulted from the "history of state-established segregation in Mississippi," coupled with the founding of new private schools in Mississippi at times reasonably proximate to public school desegregation litigation.) The court stated that its decree was limited to schools in Mississippi "because this is an action in behalf of black children and parents in Mississippi, and confinement of this aspect of our relief to schools in Mississippi applying for tax benefits defines a remedy proportionate to the injury threatened to plaintiffs and their class." The Court also stated that the "Service would be within its authority in including similar requirements" as to notification of nondiscriminatory policies) "for all schools of the nation.."

The Court specifically enjoined the IRS from approving any application for tax-exempt status under section 501(c)(3) of the Code for any private school located in the State of Mississippi unless such private school made the following showings in support of its application for exemption:

> (1) That the school has publicized the fact that it has a racially nondiscriminatory policy as to students, meaning that it admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at that school, and further meaning, specifically but not exclusively, a policy of making no discrimination on the basis of race in administration of educational policies, applications for admission, of scholarship and loan programs, and athletic and extra-curricular programs.
>
> (2) That the school has publicized this policy in a manner that is intended and reasonably effective to bring it to the attention of persons of student age (and their families) who are of minority groups. including all nonwhites.

The Court further enjoined the IRS from approving any application for tax-exempt status for any private school located in the State of Mississippi unless such school supplied the IRS with specified information, which the Court said was material if the IRS was to be in an effective position to determine whether the school had actually established a policy of nondiscrimination. The required information included:

> (1) racial composition of student body, applicants for admission, and faculty and administrative staff; and
>
> (2) amount of scholarship and loan funds, if any, awarded to students enrolled or seeking admission, and racial composition of students who have received such awards.

Affirmance by U.S. Supreme Court

The decision of the District Court in *Green* v. *Connally*, which was appealed directly to the U.S. Supreme Court by the intervenors, was affirmed by a per curiam decision in *Coit* v. *Green*, 404 U.S. 997 (1971).

The precedential effect of the Supreme Court's affirmance has been widely debated. Those who argue that the *Green* affirmance has little value as precedent point to language in another Supreme Court case, *Bob Jones University* v. *Simon*, that states as follows:[5]

> The question of whether a segregative private school qualifies under § 501(c)(3) has not received plenary review in this Court, and we do not reach that question today. Such schools have been held not to qualify under § 501(c)(3) in *Green* v. *Connally* [citation omitted]. As a defendent in *Green*, the Service initially took the position that segregative private schools were entitled to tax-exempt status under § 501(c)(3), but it reversed its position while the case was on appeal to this Court. Thus, the Court's affirmance in *Green* lacks the precedential weight of a case involving a truly adversary controversy.

Those who argue that the *Green* affirmance has precedential weight contend that decisions subsequent to 1971 have made clear that the holding in *Green* was correct as a matter of Federal constitutional law.[6] They also contend that Congress recognized the precedential value of *Green* when it added section 501(i) to the Internal Revenue Code in P.L. 94–568.[7]

D. IRS Policies Following the *Green* Case

Elaboration on nondiscrimination requirement

Subsequent to the *Green* decision, the IRS further elaborated on its policy of denying tax exemption to racially discriminatory schools. Revenue Ruling 71–447, 1971–2 C.B. 230, provided that a private school which does not have a racially nondiscriminatory policy as to students is not "charitable" within the common law concepts reflected in sections 170 and 501(c)(3), and in other relevant Federal statutes, and, accordingly, does not qualify as an organization exempt from Federal income tax. The term "racially nondiscriminatory policy as to students" was defined to mean that the school admits the students of any race to all the rights, privileges, programs, and activities generally accorded or made available to students at the school and that the school does not discriminate on the basis of race in the administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.

In support of the ruling's conclusion, the IRS stated that under the common law, the term "charity" encompasses all three of the major categories identified separately under section 501(c)(3) of the Code as religious, educational, and charitable. Thus, the ruling

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[5] 416 U.S. 725, 740 n. 11 (1974). That case, which preceded the pending litigation involving Bob Jones University, held that the Anti-Injunction Act precluded the university from maintaining an action to enjoin the IRS from revoking its tax exemption.

[6] See, for example, *Norwood* v. *Harrison*, 413 U.S. 455 (1973), holding that economic benefits cannot be extended by a State to racially discriminatory schools. *Norwood* cited the *Green* case with approval.

[7] See discussion in Part III, above.

concluded that a school which asserts the rights to the benefits provided for in section 501(c)(3) as being organized and operated exclusively for educational purposes must be a common law charity in order to be exempt under that section.

Publicity of nondiscrimination policy

Revenue Procedure 72–54, 1972–2 C.B. 834, set forth guidelines for determining whether certain private schools that have rulings recognizing their tax-exempt status, or that are applying for tax exemption, have adequately publicized their racially nondiscriminatory policies as to students. This procedure provided that a showing that a school does in fact have a meaningful number of students from racial minorities enrolled is evidence of a nondiscriminatory admissions policy; however, such a showing would not in itself be conclusive that the school has a racially nondiscriminatory policy as to students. A school that did not establish that it operated under a bona fide racially nondiscriminatory policy as to students was required, in order to qualify for exemption, to take affirmative steps to demonstrate that it would so operate in the future. The school was required to show that a racially nondiscriminatory policy as to students had been adopted; that the policy had been made known to all racial segments of the community served by the school; and that the policy was being administered in good faith.

Revenue Procedure 72–54 provided several examples of methods by which publication of a school's nondiscriminatory policy could be made. The procedure did not require the use of any particular method, so long as the method chosen effectively made the policy known to all racial segments of the community served by the school. Examples of methods that the IRS would consider as meeting the publication requirement included the publication by a school of notice of its racially nondiscriminatory policy in a newspaper of general circulation serving all racial segments of the locality from which the school's student body is drawn; the use of broadcast media by a school to publicize its racially nondiscriminatory policy; the publication of a school's nondiscriminatory policy through its school brochures and catalogues; and communication by the school of its nondiscriminatory policy to leaders of racial minorities in such a way that they, in turn, would make the policy known to other members of their race.

E. 1975 IRS Ruling and Procedure

Revised IRS guidelines

In 1975, the IRS published Revenue Procedure 75–50, 1975–2 C.B. 587, which set forth guidelines and recordkeeping requirements for determining whether private schools have racially nondiscriminatory policies. This revenue procedure superseded Rev. Proc. 72–54, *supra*.

In general, the 1975 guidelines provide that to obtain recognition of tax-exempt status under section 501(c)(3):

> (1) A school must include a statement in its charter, bylaws, or other governing instrument, or in a resolution of its governing body, that it has a racially nondiscriminatory policy as to students and, therefore, does not discriminate against applicants and
>
> (2) The school must include a statement of its racially nondiscriminatory policy as to students in all its brochures and

catalogues dealing with student admissions, programs, and scholarships.

(3) The school must make its racially nondiscriminatory policy known to all segments of the general community served by the school.

(4) The school must be able to show that all of its programs and facilities are operated in a racially nondiscriminatory manner.

(5) As a general rule, all scholarships or other comparable benefits procurable for use at the school must be offered on a racially nondiscriminatory basis. Their availability on this basis must be known throughout the general community being served by the school and should be referred to in the publicity necessary to satisfy the third requirement in order for that school to be considered racially nondiscriminatory as to students.

The procedure also required that an individual authorized to act officially on behalf of a school which claims to be racially nondiscriminatory as to students must certify annually, under penalties of perjury, that to the best of his knowledge and belief the school has satisfied the requirements listed in the procedure.

The 1975 Revenue Procedure further provided that the existence of a racially discriminatory policy with respect to employment of faculty and administrative staff would be indicative of a racially discriminatory policy as to students, while conversely, the absence of racial discrimination in employment of faculty and administrative staff would be indicative of a racially nondiscriminatory policy as to students.

Failure to comply with the guidelines set forth in Revenue Procedure 75–50 ordinarily would result in the proposed revocation of the tax-exempt status of a school.

Applicability to church schools

In 1975, the IRS also published a revenue ruling clarifying its position that private schools operated by churches, like other private schools, could not retain tax-exempt status if they were racially discriminatory.

Revenue Ruling 75–231, 1975–1 C.B. 158, concluded that church-related and church-operated organizations conducting schools with policies of refusing to accept students from certain racial and ethnic groups would not be recognized as tax-exempt charities under section 501(c)(3). The ruling stated that "there is no basis for treating separately incorporated schools that, although church-related, teach secular subjects and generally comply with State law requirements for public education for the grades for which instruction is provided, any differently than private schools that are not church-affiliated." Similarly, in the case of a school which is directly supervised and controlled within the same legal organization as the church, the ruling stated that "a racially or ethnically discriminatory policy as to students is as contrary to Federal public policy under these circumstances as it is when the educational institution is separately incorporated."

The ruling also addressed a situation in which a church operates or controls a school which discriminates on the basis of race, and where the church asserts that this discriminatory policy is required by the tenets of the religion it embraces. The ruling stated that Supreme Court cases supported the conclusions that (1) a religious basis for an

activity does not preclude governmental interference if the activity is otherwise clearly contrary to Federal public policy and (2) that while the First Amendment bars governmental interference with religious beliefs, it does not affect the legal consequences otherwise attending a given practice or action that is not inherently religious. Accordingly, such schools were ruled not eligible for section 501(c)(3) exemption.

F. *Prince Edward School Foundation* v. *United States*

In *Prince Edward School Foundation* v. *United States*, 478 F. Supp. 107 (D.D.C. 1979), aff'd per curiam by unpublished order No. 79–1622 (D.C. Cir. June 30, 1980), cert. denied, 450 U.S. 944 (1981), the U.S. District Court for the District of Columbia applied its decision in *Green* v. *Connally*, *supra*, to private schools outside Mississippi and held that a school with a racially discriminatory admissions policy is not entitled to tax exemption under section 501(c)(3).

The District Court upheld the IRS denial of tax-exempt status to the Foundation, which operated a private school in Virginia, because the school failed to satisfy its burden of establishing that it maintained a racially nondiscriminatory admissions policy. The U.S. Court of Appeals for the D.C. Circuit affirmed the District Court's opinion in an unpublished order, and the U.S. Supreme Court denied certiorari. Justice Rehnquist, joined by Justices Stewart and Powell, dissented to the denial of certiorari. In his dissent, Justice Rehnquist stated in part: "Given the general rule that words of a statute, including the Revenue Acts, should be interpreted where possible in their ordinary, everyday sense * * *, the authority of the Secretary of the Treasury to promulgate this policy regarding the tax status of private schools is sufficiently questionable to merit review by this Court. Perhaps, implementation by the Service of the express language of the statute will, as suggested by the District Court in *Green* v. *Connally*, create problems of a constitutional nature." The dissent also stated that "the time has come for this Court to deal with the difficult statutory and constitutional questions raised" in this case.

G. Further Proceeding in *Green* v. *Connally*

In 1976, the plaintiffs in the *Green* case sought further injunctive relief from the U.S. District Court for the District of Columbia, asserting that the IRS was not complying with the Court's continuing injunction that Mississippi private schools which are racially discriminatory must be denied exemption from Federal income tax. The District Court supplemented and modified the permanent injunction relating to the tax-exempt status of Mississippi private schools which had been entered in 1971 (*Green* v. *Miller*, 45 AFTR 2d 80–1566 (D.D.C. 1980)).

The injunction was modified, in part, to restrain the IRS from according tax-exempt status to, and from continuing any tax-exempt status enjoyed by, all Mississippi private schools that have been determined in adversary or administrative proceedings to be racially discriminatory; or that were established or expanded at or about the time the public school districts in which they are located or which they serve were desegregated and which cannot demonstrate that they do

not racially discriminate in admissions, employment, scholarships, loan programs, athletics, and extracurricular programs. The IRS also was ordered to conduct a survey of all Mississippi private schools meeting those criteria, including all church-related schools.

As a result of the IRS survey ordered by the District Court, five private schools' tax exemptions have been withdrawn by the IRS. These schools have filed declaratory judgment actions in the U.S. Tax Court, seeking to have their tax-exempt status restored.

After the District Court's action in 1980, the IRS revoked the tax-exempt status of a number of church-affiliated schools. The Clarksdale Baptist School has been allowed to intervene in the District Court proceedings, where it contends that the IRS revocation of its tax-exempt status is a violation of the First Amendment to the Constitution. On January 6, 1982, the District Court stayed all further proceedings pending the Supreme Court's ruling in the Bob Jones University and Goldsboro Christian Schools cases (discussed below).

H. *Wright* v. *Regan*

In a companion suit, a group of parents of black children attending public schools in several States (*Wright* v. *Miller*, 480 F. Supp. 790 (D.D.C. 1979), rev'd *sub nom. Wright* v. *Regan*, 656 F. 2d 820 (D.C. Cir. 1981)), asserted that the IRS enforcement of the nondiscrimination requirement, on a nationwide basis, had been ineffective. The plaintiffs urged that the IRS be required to deny tax-exempt status to private schools that have insubstantial or no minority enrollments, that are located in or serve desegregating public school districts, and that: (a) were established or expanded at or about the time the public school districts in which they are located or which they serve began desegregating; (b) had been determined in adversary judicial or administrative proceedings to be racially segregated; or (c) could not demonstrate that they did not provide racially segregated educational opportunities for white children avoiding attendance in desegregating public school systems.

The District Court dismissed the suit on the ground that the plaintiffs lacked standing.[8] The District Court based its decision primarily on the grounds that the plaintiffs could not show that there was: (1) a distinct, palpable, and concrete injury; (2) an injury that was fairly traceable to the defendant's action; (3) a sufficient degree of certainty that the relief requested would remove the injury; and (4) a sufficient degree of concrete adverseness between the plaintiff and the defendant. The Court stated that any violation of the Constitution or Federal law by a school which discriminates should be remedied on a case-by-case basis through a lawsuit filed directly against the offending school. The Court further stated that recent Congressional activity (i.e., the

[8] "Standing" refers to the ability of a party to have his complaint heard by the court. In one case, the U.S. Supreme Court has stated that the "gist of the question of standing" is whether the party seeking relief has "alleged such a personal stake in the outcome of the controversy as to assure that concrete adverseness which sharpens the presentation of issues upon which the court so largely depends for illumination of difficult constitutional issues." (*Baker* v. *Carr*, 369 U.S. 186, 204 (1962)). See also *Duke Power Co.* v. *Carolina Environmental Study Group, Inc.*, 438 U.S. 59 (1978); *Simon* v. *Eastern Kentucky Welfare Rights Org.*, 426 U.S. 26 (1976).

Ashbrook and Dornan amendments, which are discussed more fully below) indicated that it should not fashion a remedy in this area.

However, the U.S. Court of Appeals for the D.C. Circuit in *Wright* reversed the District Court (in a 2 to 1 decision) and recognized the right of black citizens to insist that the government "steer clear" of aiding schools in their communities that practice racial discrimination, even though such individuals had no personal interest in attending those schools. The D.C. Circuit noted that potential action by the legislature did not supply an acceptable basis for avoiding a decision on the merits, and that appropriations limitations do not purport to control judicial dispositions. The case was remanded to the District Court for decision.

The Government has petitioned the Supreme Court for a writ of certiorari on the standing issue, and further proceedings in the District Court have been stayed pending a decision by the Supreme Court on whether to grant that petition.

I. Proposed Revenue Procedures Relating to Racially Discriminatory Private Schools

The reopening of the *Green* case and the *Wright* litigation led the IRS to conclude that its prior procedures had not proved effective in identifying schools that were discriminating on the basis of race in actual operation, even though they had professed an open enrollment policy and had complied with the requirements of Revenue Procedure 75–50.

On August 21, 1978, the IRS announced prospective publication of a revenue procedure intended to revise administrative guidelines for determining whether a private school operates in a racially discriminatory manner.[9] This initial proposal was substantially and on February 9, 1979, the IRS published another proposed procedure.[10]

The proposed revenue procedure issued on February 9, 1979 would have applied to two categories of private elementary and secondary schools. The first group consisted of "adjudicated schools", which had been found to be racially discriminatory by a Federal or State court administrative agency. The second category consisted of "reviewable schools," defined as schools whose formation or substantial expansion was related to public school desegregation in the community and which lacked significant minority student enrollment.

The proposed guidelines would have required that determinations about whether schools have racially nondiscriminatory policies with respect to students be based on all applicable facts and circumstances. An administrative "safe harbor" would have been established so that schools whose minority enrollment was 20 percent (or more) of the percentage of minority school age population in the community ordinarily would not have been reviewable. The guidelines also would have provided a nonexclusive list of factors tending to show whether a school's formation or expansion was related to public school desegre-

[9] I.R. News Release 2027. This proposed revenue procedure was published in the Federal Register on August 22, 1978.

[10] I.R. News Release 2091. This revised proposal was published in the Federal Register on February 13, 1980.

gation, as well as whether a reviewable school should be tax exempt because it had made a good faith effort to attract minority students. The guidelines set forth procedures for handling revocation of exempt status, new applications for tax-exemption, and IRS National Office review of adverse determinations.

Neither of the proposed procedures was implemented. Hearings on the proposed procedures were held before the Ways and Means Oversight Subcommittee on February 20, 21, 22, 26, and 28, and March 12, 1979.

J. Appropriation Riders

Effective October 1, 1979, further IRS action regarding the issue of tax exemptions for racially discriminatory private schools was stayed by Congress through amendments to the Treasury Appropriations Act of 1980 (P.L. 96–74). Two appropriations riders, known as the "Dornan amendment" and the "Ashbrook amendment," deal specifically with the issue. The Dornan amendment provides that none of the funds made available under the Act may be used to carry out the proposed revenue procedure of August 22, 1978, or the revised proposed revenue procedure of February 13, 1979. The Ashbrook amendment as originally in force provided more generally that no funds may be used "to formulate or carry out any rule, policy, procedure, guideline, regulation, standard, or measure which would cause the loss of tax-exempt status to private, religious, or church-operated schools under section 501(c)(3) of the Internal Revenue Code of 1954 unless in effect prior to August 22, 1978."

The Ashbrook amendment as currently in effect provides that funds may not be used "to formulate or carry out any rule, policy, procedure, guideline, regulation, standard, *court order*, or measure which would cause the loss of tax-exempt status to private, religious, or church-operated schools under section 501(c)(3) of the Internal Revenue Code of 1954 unless in effect prior to August 22, 1978" [emphasis added]. See Public Law 97–92 (continuing appropriations for fiscal year 1982) and H.R. 4121, as passed by the House and reported by the Senate Appropriations Committee (Treasury, Postal Service, and General Government Appropriations Act, 1982).[11]

[11] Reported from the House Appropriations Committee on July 9, 1981 (H. Rep. No. 97–171); passed by the House on July 30, 1981; reported by the Senate Appropriations Committee on September 22, 1981; and Senate consideration started, but not completed on December 14, 1981.

V. BOB JONES UNIVERSITY AND GOLDSBORO CHRISTIAN SCHOOLS, INC. CASES

A. Bob Jones University Case

Background

Bob Jones University (the "University") was founded in 1927 in Florida and was moved to Greenville, South Carolina, in 1940, where it has been incorporated as a nonprofit organization since 1952. The University enrolls approximately 5,000 students from kindergarten through college and graduate school, and offers some 50 accredited degrees, in addition to a nondegree program in its Institute of Christian Service which teaches the principles of the Bible and trains Christian character.

The University is not affiliated with any religious denomination, but is devoted to the teaching and propagation of its fundamentalist religious beliefs. Prior to September 1971, these beliefs prohibited admission of black students to the University. In 1971, the University revised its admissions policies so that married black students and members of other minority races were not excluded from enrollment. Since May 1975, the University has had an open admissions policy, but maintains prohibitions against interracial marriage and dating.

Until 1970, the IRS recognized the University as a tax-exempt organization described in Code section 501(c)(3). In November 1970, the IRS sent letters to numerous organizations operating private schools, including the University, announcing that no private school that maintained a racially discriminatory admissions policy was entitled to tax exemption or could receive deductible charitable contributions. After a series of administrative and court proceedings,[1] the University's tax-exempt status was officially revoked by the IRS in January 1976, because of the University's policies concerning interracial marriage and dating. The revocation was made effective from December 1970.

District Court decision

The University then paid $21 in Federal unemployment taxes with respect to one employee for 1975 and sued for a refund in the U.S. District Court for the District of South Carolina. The Government counterclaimed for approximately $490,000 in unpaid Federal unemployment taxes for the taxable years 1971 through 1975. The District Court decided that, on both statutory and constitutional grounds, the

[1] In 1971, the University filed an action in the U.S. District Court for the District of South Carolina, to enjoin the IRS from revoking its tax-exempt status. That suit culminated in *Bob Jones University* v. *Simon*, 416 U.S. 725 (1974), in which the U.S. Supreme Court held that the University was precluded by the Anti-Injunction Act (Code sec. 7421(a)) from maintaining such an action, but suggested a refund suit as a means of access to judicial review.

IRS was without authority to revoke the University's tax-exempt status (*Bob Jones University* v. *United States*, 468 F. Supp. 890 (D.S.C. 1978)).

In applying section 501(c)(3), the District Court found the language of the statute unambiguous and saw no indication in the legislative history that Congress intended to limit exemptions only to organizations meeting the qualifications of charitable trusts under the common law, as the Government had argued. The Court found that the University's "primary purpose is religious and that it exists as a religious organization." It held that since section 501(c)(3) and the regulations enumerate seven separate and distinct exempt purposes, one of which is "religious," tax exemption must be granted once it is determined as a fact that the organization fits into any one of the enumerated categories. In so holding, the Court noted that the IRS nondiscrimination policy, as set forth in its rulings and procedures, applies only to educational organizations and not to religious organizations that practice racial discrimination.

The District Court proceeded to address the Government's argument that organizations which violate clearly defined Federal public policy, in this case the policy against discrimination by schools on the basis of race in the selection of students, may not be granted tax exemptions as organizations described in section 501(c)(3). The Court concluded that other courts that had applied public policy limitations in the context of section 501(c)(3)[2] to disallow tax exemptions to schools that practice racial discrimination "did not fully consider the nature of the limitation they engrafted on the statute."

Also, the District Court stated that judicially created "public policy" limitations on the allowance of tax exemptions or deductions are restricted to those cases where allowance of the tax benefit "directly and in a significant manner frustrates the clearly defined policy," such as where an expenditure itself is illegal or is paid as a penalty for an unlawful act.[3] The Court described the relationship between allowance of the University's tax exemption and frustration of the national policy against racial discrimination as "tenuous," and, furthermore, considered the IRS nondiscrimination policy, as reflected in rulings and procedures, to be an abuse of the power delegated to the IRS by Congress.[4]

The District Court also held that the revocation of the University's tax-exempt status was an unconstitutional infringement of the

[2] The Court cited the decisions in *Green* v. *Connally*, 330 F. Supp. 1150 (D.D.C.), aff'd per curiam sub nom. *Coit* v. *Green*, 404 U.S. 997 (1971), and *Goldsboro Christian Schools, Inc.* v. *U.S.*, 436 F. Supp. 1314 (E.D.N.C. 1977).

[3] In support of this view, the Court cited *Tank Truck Rentals* v. *Comm'r*, 356 U.S. 30 (1953), where the Supreme Court disallowed deduction of fines for highway weight violations since allowing the deduction would frustrate sharply defined public policy and encourage violations.

[4] In this regard, the Court stated that the Government's "blanket policy announcements in Revenue Rulings and Procedures 71-447, 72-54, 75-50, and 75-231, that it will deny tax exempt status to organizations which racially discriminate, but otherwise qualify under § 501(c)(3), constitute a use by the IRS of the federal tax law as a sanction for what it considers a wrongdoing, or its idea of proper social conduct of persons of different races, uses of the Code prohibited by the Supreme Court * * *. The section is to become the IRS's mechanism for disciplining wrongdoers or promoting social change" based on its conception of Federal public policy. (468 F. Supp. at 905)

University's First Amendment right to the free exercise of its religious beliefs.[5] The religious belief involved was the University's prohibition of interracial dating and marriage and its refusal to admit any person involved in such a relationship. The Court found that U.S. Supreme Court decisions holding unconstitutional State laws which required discrimination on the basis of the race of a person's companion did not "represent a compelling public policy against this variety of racial discrimination in the private sector," and that "there has yet to be expressed any compelling public policy prohibiting racial discrimination by religious organizations." [6] Thus, it held that enforcement of the IRS nondiscrimination policy violated the University's right to practice freely its religious beliefs because it was forced to give up a valuable government benefit, i.e., its tax-exempt status and deductibility of contributions by donors, in order to practice its religion.

Reversal by Fourth Circuit

The U.S. Court of Appeals for the Fourth Circuit, in a 2–1 decision, reversed the District Court (*Bob Jones University* v. *United States*, 639 F.2d 147 (4th Cir. 1980)). The Fourth Circuit held that the revocation of the University's tax-exempt status violates neither the statutory mandate of section 501(c)(3) nor the First Amendment of the Constitution.

The Fourth Circuit rejected the District Court's conclusion that the University was entitled to tax-exempt status because it is a religious organization under one of the enumerated exempt purposes in section 501(c)(3). The Court termed this a "simplistic reading of the statute" and concluded that section 501(c)(3) must be viewed against its background in the law of charitable trusts. To be eligible for tax-exempt status, "an institution must be 'charitable' in the broad common sense and therefore must not violate public policy." [7]

The Fourth Circuit found that the University's racial policies violated clearly defined public policy, rooted in the Constitution and a series of U.S. Supreme Court decisions, condemning racial discrimination. The Court cited *Runyon* v. *McCrary*, 427 U.S. 160 (1975), in which the Supreme Court held that, in a nonreligious setting, the equal right to contract provision, 42 U.S.C. § 1981, prohibits racial discrimination in private school admissions policies. The Court also cited equal protection cases, such as *Loving* v. *Virginia*, 388 U.S. 1 (1967) (State law prohibiting interracial marriage unconstitutional), and *McLaughlin* v. *Florida*, 379 U.S. 184 (1964) (interracial cohabitation law held invalid). The Court held that the IRS was within its statutory authority in revoking the University's tax-exempt status

[5] The First Amendment to the Constitution, in part, provides: "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof * * *."

[6] However, the Court stated that, even assuming the University was an educational organization, the revocation of its tax-exempt status was a violation of its free exercise rights.

[7] The Court cited *Green* v. *Connally* and stated that "this view finds additional support in the statutory framework itself: Section 170 of the Code, the companion provision to 501(c)(3), places the separately enumerated purposes in that section under the broad heading of 'charitable' and permits deduction of contributions made to organizations serving those purposes, 26 U.S.C. § 170 (c)(2)(B)." (639 F. 2d at 151 n. 6)

and stated that the IRS "nondiscrimination policy assures that Americans will not be providing indirect support for any educational organization that discriminates on the basis of race."

The Fourth Circuit stated that the same public policy considerations apply in a religious setting. The Court cited *Bob Jones University* v. *Johnson*, 396 F. Supp. 597 (D.S.C. 1974), aff'd (without published opinion), 529 F.2d 514 (4th Cir. 1974), which held that the University s then policy of excluding unmarried blacks required the termination of Federal assistance programs to veterans at the University, under the provision of Title VI of the Civil Rights Act, 42 U.S.C. § 2000d, forbidding such Federal assistance for discriminatory schools.

The Fourth Circuit addressed the District Court's opinion that tax exemptions and deductions are subject to public policy limitations only where an expenditure itself is illegal or is paid as a penalty for an unlawful act (see *Tank Truck Rentals* v. *Comm'r*, *supra*). The Court stated that, "The Constitution commands that government not provide any form of tangible assistance to schools which discriminate on the basis of race. *Norwood* v. *Harrison*, 413 U.S. 455 (1973)." In *Norwood*, the Supreme Court held unconstitutional a State's textbook lending program to schools, including private schools that had racially discriminatory policies. The Fourth Circuit also stated that, "The grant of tax exempt status to any institution necessarily confers upon it a kind of monetary benefit and constitutes a form of government support. *Walz* v. *Tax Commission*, 397 U.S. 664, 674–75 [citation omitted] (1970). * * * This is not to say that the tax benefit turns the University's policy into government action for Equal Protection Clause purposes. We do think, however, that government must 'steer clear' of affording tax support to educational institutions that practice racial discrimination." (639 F.2d at 152, n. 7)

The Fourth Circuit also rejected the University's claim that revocation of its tax-exempt status violated the First Amendment of the Constitution. The Court found that the burden imposed upon the University's ability to exercise its religion was not so great as to overcome the compelling interest of the government in eliminating all forms of racial discrimination. Assuming that the University's racially discriminatory policies are motivated by sincere religious beliefs, the Court noted that application of the IRS non-discrimination policy would not prohibit the University from adhering to its policies or force any individual to violate his beliefs. Finally, the Court concluded that the uniform application of the IRS non-discrimination policy to all religiously operated schools "*avoids* the necessity for a potentially entangling inquiry into whether a racially restrictive practice is the result of a sincere religious belief."

The dissenting judge in the Fourth Circuit generally agreed with the District Court's opinion that the University is a religious organization entitled to exemption under section 501(c)(3) since it qualifies under one of the exempt purposes enumerated in that statute. That judge viewed the case as one of "first impression" raising the issue of whether public policy favoring freedom of religion as expressed in the First Amendment is to be limited by public policy against indirect government support of educational institutions that discriminate on the basis of race. He found nothing to show that the two policies may not exist "side by side," stating that "There is no reason

I know of that the policy favoring non-discrimination is so strong that it will not admit the existence of a religious organization which does in fact discriminate."

B. Goldsboro Christian Schools, Inc. Case

Background

Goldsboro Christian Schools, Inc. (the "School") was organized in 1963 as a nonprofit corporation exclusively for the purpose of operating a private, fundamentalist religious school in Goldsboro, North Carolina. The School is affiliated with the Second Baptist Church of Goldsboro, which has provided both physical facilities and monetary support to the School since its founding. Since its establishment, the School has maintained a racially discriminatory admissions policy, denying admission to blacks on the basis of its religious beliefs.

The School never received a determination by the IRS that it was an organization qualified for tax exemption and other tax benefits under section 501(c)(3). On audit for the years 1969–72, the IRS determined that the School was not qualified under section 501(c)(3), and, therefore, was required to pay Federal social security and unemployment taxes for those years. The School then paid these taxes with respect to one employee for the years 1969–72 and filed a refund suit in the U.S. District Court for the Eastern District of North Carolina to recover $3,459.93 in taxes paid. The Government counterclaimed against the School to recover approximately $160,000 in unpaid Federal social security and unemployment taxes for those years.

Court decision

The issue in the District Court was whether the School was a section 501(c)(3) organization so as to qualify for exclusion from these employment taxes. The Court held that private schools maintaining a racially discriminatory admissions policy violate clearly declared public policy of the United States and, therefore must be denied the Federal tax benefits flowing from qualification under section 501(c)(3) (*Goldsboro Christian Schools, Inc.* v. *United States*, 436 F.Supp. 1314 (E.D.N.C. 1977)).

In support of its decision, the District Court cited *Green* v. *Connally*, *supra*, and referred to Federal policy as expressed in the Thirteenth and Fourteenth Amendments to the Constitution, Civil Rights Acts, and *Brown* v. *Board of Education*, *supra*, and its legal progeny. The District Court then stated:

> "Given this clearly declared federal policy against racial bars to educational institutions, it would be at least anomalous and unseemly to confer federal tax benefits (having the purpose and effect of fostering and encouraging the organizations upon whom they are conferred) upon educational institutions which do, in fact, discriminate on racial grounds. Accordingly, Section 501(c)(3) must be read as imposing a general limitation prohibiting qualification for educational organizations that do practice racial discrimination." (436 F.Supp. at 1319)

The School argued that its racially discriminatory admissions policy is based on religious belief and that denial of qualification under

section 501(c)(3) would violate the First Amendment to the Constitution. Applying tests established by the Supreme Court in this area, the District Court concluded that (1) there is a legitimate secular purpose for denying tax exemptions to schools practicing racial discrimination, (2) the general across-the-board denial of tax benefits to such schools is essentially neutral, in that its principal or primary effect cannot be viewed as either enhancing or inhibiting religion, and (3) the policy patently avoids excessive government entanglement with and, in fact, prevents indirect government aid to, religion.

The U.S. Court of Appeals for the Fourth Circuit, in an unpublished 2–1 opinion, affirmed the decision on the authority of its decision in *Bob Jones University* v. *United States*, *supra*.

C. Current Status of Cases

In July 1981, both Bob Jones University and Goldsboro Christian Schools, Inc. filed petitions for writs of certiorari seeking U.S. legality of the denial of their tax-exempt status.

In September 1981, the Government filed a brief acquiescing in the request for certiorari. The Government argued that the Fourth Circuit correctly had held that the IRS acted within its statutory authority in revoking tax-exempt status under section 501(c)(3). In its brief, the Government also argued that the IRS nondiscrimination policy derives its force from the Congressional intent underlying the charitable exemption provisions of the Code and from "the federal government's commitment to the eradication of racial discrimination in education manifested both in the Constitution and in many federal statutes and the national policy prohibiting public subsidy of racially discriminatory educational institutions, whether public or private." The Government's brief stated that the Fourth Circuit correctly had concluded that "the unquestioned First Amendment right to free religious belief and exercise does not carry with it a guarantee of any person's or corporation's entitlement to tax-exempt status."

On October 13, 1981, the Supreme Court granted certiorari in the two cases and ordered consolidation. On January 8, 1982, the Government filed a Memorandum in the Supreme Court asking that the judgments of the Fourth Circuit Court of Appeals be vacated as moot.

This Memorandum stated that the Treasury Department has initiated the steps necessary to provide Bob Jones University and Goldsboro Christian Schools, Inc. with tax-exempt status and to refund to them the Federal social security and unemployment taxes in dispute. The Memorandum stated, further, that the Treasury Department has commenced the process necessary to revoke certain published IRS rulings relating to denial of tax-exempt status to private schools with racially discriminatory policies.

On January 14, 1981, Bob Jones University and Goldsboro Christian Schools, Inc. each filed a Memorandum in the Supreme Court supporting the position of the Government that the Fourth Circuit's decisions be vacated as moot.

VI. ADMINISTRATION LEGISLATIVE PROPOSAL

General provisions

The Administration has proposed legislation to prohibit tax-exempt status for private, nonprofit educational organizations that have racially discriminatory policies.

Specifically, under the Administration proposal, an organization that normally maintains a regular faculty and curriculum (other than an exclusively religious curriculum) and that normally has a regularly enrolled body of students in attendance at the place where its educational activities are regularly carried on will not be exempt from tax if the organization has a racially discriminatory policy.

Under the proposal, such an organization would have a racially discriminatory policy (and therefore be denied exemption) if (1) it refuses to admit students of all races to the rights, privileges, programs, and activities generally accorded or made available to students by that organization, or if (2) it refuses to administer its educational policies, admissions policies, scholarship and loan programs, athletic programs, or other programs administered by the organization in a manner that does not discriminate on the basis of race.

Religious schools

The proposal contains a special rule for religious schools. Under this special rule, an admissions policy of a school, or a program of religious training or worship of a school, that is limited, or grants preferences or priorities, to members of a particular religious organization or belief generally would not be a racially discriminatory policy. However, if such policy, program, preference, or priority is based upon race or upon a belief that requires discrimination on the basis of race, tax-exempt status would be unavailable.

Deductibility of contributions

Finally, the proposal would deny deductions for contributions to organizations maintaining schools with racially discriminatory policies. This denial of deduction would apply with respect to income, estate, and gift taxes.

Effective date

The Administration proposal would be effective as of July 10, 1970 (the date of the IRS news release announcing its racial nondiscrimination policy as to tax-exempt status).

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